Illegal Flipping and Neighborhood Inequality: A Slavic Village Case Study

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Abstract

Recently there has been extensive research on the changing face of inequality in the U.S. housing market. Initially, the expansion of mortgage loaning to subprime borrowers was seen as an equalizing opportunity for people with tarnished credit records or those susceptible to discrimination to own a home. Instead, many people without enough income and the proper credentials to own a home are able take out a hefty mortgage that they cannot afford and subsequently lose their homes. In addition, it has opened opportunities for inexperienced home buyers to become targets for predatory loans. However, there is yet another consequence resulting from the relaxed lending practices which has received much less attention. Recently, there has been an increase of fraudulent activity detected which is not directly aimed at cheating the borrower. This fraud-for-profit scheme involves a wide range of illegal activities which intentionally leads to the foreclosure of properties, devastates neighborhoods, and defrauds banking institutions. The neighborhood blight is severe and has negative consequences for residents such as an inability to sell their property, a rise in crime, and unfounded property valuation increases. My research examines the gap in neighborhood inequality research dealing with the fraudulent property flipping form of mortgage fraud through a case study of Slavic Village in Cleveland, Ohio. I examine the prevalence and process of illegal flipping in Slavic Village using federal and local government data, and conduct systematic neighborhood observation of the contribution of flipping to neighborhood deterioration.

Recently there has been extensive research on the changing face of inequality in the U.S. housing market. Initially, the expansion of mortgage loaning to subprime borrowers was seen as an equalizing opportunity for people with tarnished credit records or those susceptible to discrimination to own a home (Chomsisengphet and Pennington- Cross 2006). Instead, many people without enough income and the proper credentials to own a home are able take out a hefty mortgage that they cannot afford and subsequently lose their homes. In addition, it has opened opportunities for inexperienced homebuyers as targets for predatory loans. Regardless of any good intentions, the expansion of mortgage lending to subprime borrowers is nonetheless problematic as it has only enhanced inequalities rather than eliminating them.

However, there is yet another consequence resulting from the relaxed lending practices. Recently, there has been an increase of fraudulent activity detected which is not directly aimed at cheating the borrower. The practice of illegal flipping, which had been virtually undetected for some time, has emerged as the most common mortgage fraud practice (FBI.gov 2006). This fraud-for-profit scheme involves a wide range of illegal activities which intentionally leads to the foreclosure of properties devastates neighborhoods and defrauds banking institutions. The neighborhood blight is severe and has negative consequences for residents such as; an inability to sell their property, a rise in crime, and unfounded property valuation increases. On a larger scale, the foreclosures and other negative consequences perpetuate stratification and neighborhood segregation. Moreover there may be additional implications on the national level due to the bankruptcy of lending institutions and an increase in foreclosures. Ultimately, this may have had grave consequences possibly contributing to the subprime mortgage crisis, property overvaluation, bursting of the housing bubble and the current economic recession.

Whereas in the past, redlining was a popular institutionalized form of neighborhood inequality, illegal flipping has become a new avenue in augmenting segregation and stratification. The questions then arise, how has this change in institutionalized practices changed over time? Have there been significant changes in the mortgage lending process that allowed for this practice? Furthermore, how does the process occur? It has also raised the question of how these practices contribute to urban blight. My research will therefore focus on the extent of the social and economic damage on neighborhoods. For example, how prevalent is this practice and is it concentrated in certain areas? I hypothesize that fraudulent flipping will be prevalent in certain low income neighborhoods and even show the extent of the damage through entire streets with mainly foreclosed and abandoned properties. Generally, this research project will focus on how predatory flipping has been influential in the new face of housing inequality and perpetuates the stratification of low income neighborhoods.

My research examines the gap in neighborhood inequality research dealing with the fraudulent property flipping form of mortgage fraud through a case study of Slavic Village in Cleveland, Ohio. Once a thriving industrial neighborhood comprised of Czech and Polish immigrants, Slavic Village has faced a great deal of change in the last few decades. The old neighborhood has deteriorated greatly and experienced an influx of low-income minorities, mainly African Americans (NHlink.net). I chose to focus on Slavic Village for the case study because it is known to be the epicenter of predatory flipping and has been hit hard by the foreclosure crisis. The result has been a neighborhood filled with vacant and boarded-up properties. The media has dubbed Slavic Village "Ground Zero" based on its reputation for being inflicted with numerous flipping schemes. This distinction is largely due to the exploits of one particular group of people responsible for 78 flipped properties in the area (CNN money.com; prosecutor.cuyahogacounty.us).

Predatory flipping is a newly publicized form of mortgage fraud that plagues the mortgage lending agencies and has serious consequences on a neighborhood's condition, foreclosure rates, property values, crime incidence, and costs to the government, leading to severe deterioration of the neighborhood and ultimately reinforcing neighborhood inequality. The pervasiveness of flipping and its oppressive burden on a neighborhood are exemplified in the case study of Slavic Village. In addition to local effects, predatory flipping may also have had an impact on the current subprime mortgage crisis and housing bubble burst both locally and nationally.

BACKGROUND: SLAVIC VILLAGE AND THE HOUSING CRISIS

Slavic Village is a historically ethnic neighborhood located in Cleveland, Ohio east of downtown, which has encountered a great deal of change in recent decades typical of a Cleveland neighborhood. A once thriving industrial working class neighborhood comprised of Czech and Polish immigrant families has now essentially turned to slums (nhlink.net). Widespread suburbanization, change in the racial makeup, aging infrastructure, and economic restructuring all occurred in Slavic Village changing the nature of the community and essentially representing the economic segregation in Cleveland (journalism.nyu.edu 2008; nytimes.com 2009; Senate Hearing on Crisis: Cleveland Under Siege).

Then, in the 1990s the neighborhood found itself in the midst of a comeback. The Slavic Village Community Development Corporation and other non-profit and government organizations instituted significant improvement and stabilization efforts which in turn increased housing prices. At this time, it was the goal to revitalize the neighborhood by increasing the tax base and improving local resources, (Interview; Task Force Report 2008; Case Western Reserve Symposium).

Unfortunately, these efforts eventually backfired. The attraction of the revitalization and rising home prices made Slavic Village appeal to inexperienced homebuyers, prime targets for aggressive subprime lending tactics (Interview; nytimes.com 2009; journalism.nyu.edu 2008). Slavic Village became disproportionately dominated by subprime loans. Between 2005 and 2006, 68% of loan originations in the area were of the high-cost type; whereas, during that same period nationally, only 28% were reported high-cost loans. (Task Force; HDMA).

The result was severe deterioration and a foreclosure epidemic. Foreclosures increased 600% since 2000 resulting in the appearance of a grave number of vacant and abandoned homes (Task Force; HDMA; NeoCando.case.edu). During this period, a significant trend in mortgage fraud occurred in the form of fraudulent property flipping. Fraudulent Flipping involves key players including buyers, sellers, and appraisers, who obtain false documents in order to sell cheap, dilapidated properties in low income neighborhoods for an inflated profit by taking advantage of relaxed mortgage lending restrictions. Flipping was able to take place in Slavic Village because it was masked by the pre-existing housing bubble.

Essentially, the increasing home prices and housing demand in Slavic Village created its own local housing bubble boom and bust and is representative of the national housing and financial problems in the greater United States. A housing bubble involves extremely elevated property valuations over time. People buy homes at inflated prices with hopes of future appreciation and due to this speculation, prices should continue to rise. However, continued price growth is unsustainable and will peak until it becomes unaffordable (Karlsson 2004; Roberts 2008). Eventually in the United States this proliferation became unable to sustain itself, and prices began to drop in 2006.

The Case-Schiller home price index indicated that Cleveland is one of the cities that did not initially experience a housing bubble like the rest of the United States. It contended that since prices only appreciated moderately, the eventual bust will also be moderate. However, the Cleveland Federal Reserve Bank reports indicate that there actually occurred a greater difference then originally thought when examined by price tiers. The low price tier (under $111,071) actually did indicate a bubble, appreciating by more than 6% per year between 1987-2005. Since that period, there has been 37% price depreciation in the low tier. This seems to be indicative of the situation in Slavic Village.

Moreover, Slavic Village is representative of the subprime lending and foreclosure crisis. Deregulation of the lending market allowed for irresponsible lending to unworthy homebuyers such as no-doc loans which allow for little oversight while lenders make a profit. Also, it allowed for predatory practices such as exceedingly high interest rates. Subprime and predatory lending paved the way for the foreclosure crisis, with many borrowers defaulting.

HOUSING MARKET PRACTICES AND INEQUALITY

It is important to consider the history of segregation practices in order to understand the new inequality and how the extension of flipping has impacted it. In the past, neighborhood inequality was achieved through institutionalized stratification practices which were very different than the mechanisms that are used today. In fact, the main purpose of the old inequality was to deny loans and homeownership to targeted groups of people, mainly the poor and African American communities; whereas today because of the extension of subprime lending, the same groups are offered unwarranted credit, under predatory terms, with hardly any collateral.

Old Inequality

The housing sector has long been a determinate of uneven development and social stratification (Gotham, 2002). Throughout the history of housing policy, privatism has been the underlying theme. It is the laissez- faire policy based on individualism and self interest that has long been a value of the U.S. government in which business is entitled to have relatively free range for the good of the market (Squires 1994). Gotham (2002) explains the pervasiveness of privatism in the United States: "as an ideology and political strategy, privatism has been the mechanism through which public policy and private actions have traditionally reinforced and perpetuated elite corporate interests and social inequalities,"(10). The elite interests shape government policy, including in the housing sector. Many researchers of spatial inequality (Gotham 1994; Squires 2006; Williams, Nesiba, and Mcconnell 2005) attribute this philosophy to be the basis for allowing institutionalized stratification practices and thus uneven development.

The development of the modern mortgage system that began in the 1930s was initiated to stimulate home building and restructure the U.S. banking and lending institutions following the crash of the banking system in the Great Depression. Unfortunately, it also marked the beginning of federally endorsed policies condoning institutionalized racism in the housing market. In fact, the National Housing Act of 1934 was intended to increase demand and make home loans more affordable. The 1934 Housing Act created the Federal Housing Administration (FHA) to create a fair mortgage lending system. It established low down payments, high loan-to-value ratios, and long-term amortization in government loans which increased the payment schedule time through monthly payments (Gotham 2002; HUD). The new FHA insurance policy for private mortgage lenders provided "protection against losses as the result of homeowners defaulting on their mortgage loans," (HUD) which increases the tendency to lend. Despite the sound mortgage system restructuring, the elitist real estate community had control over policy making during this crucial reformation period enabling the advancement of their own ideology (Gotham 2002).

This ideology incorporated privatism and racial discrimination in the housing sector. The main goal of the real estate elites was to create racially homogeneous neighborhoods. Neighborhood segregation was achieved through the legal use of restrictive covenants and subdivisions. Property owners and neighborhood associations formed agreements which legally prohibited minorities especially Blacks, from buying or renting property in White neighborhoods. Real Estate Boards and neighborhood organizations ensured the implementation of these practices (Carr and Kutty 2008; Gotham 2002; Massey and Denton 1993). The rationale was that racially and socially homogenous neighborhoods protected property values. African Americans were actually seen as an economic liability. This advanced the practice of redlining, or denying loans to areas evaluated as high risk including poor and minority neighborhoods. Redlining was a legal practice sanctioned by the FHA which determined in the 1939 Underwriting Manual that "if a neighborhood is to retain stability it is necessary that properties shall continue to be occupied by the same social and racial classes," (Carr and Kutty 2008).

Appraisals and evaluation of property values was essential in deciding whether an area was suitable for loaning and ultimately advanced the system of institutionalized segregation. Lenders determine property values based on an appraisal and the value of a property was largely determined by the racial and ethnic concentration (Squires 1994). In fact, Gotham (2002) illustrates that, the use of covenants "stimulate consumer demand for racially exclusive neighborhoods, and in effect, established the precept that the value of housing is dependent on the race of the occupants," (23). This ultimately "helped nurture emerging racial prejudices and stereotypes that associated black residence with declining property values, [and] deteriorating neighborhoods," (23). This was also seen in the practice of redlining which blatantly denied loans to areas deemed unsuitable based on property values, or rather neighborhoods that were racially mixed (Carr and Kutty 2008; Gotham 2002; Massey and Denton 1993; Squires 1994).

The next step in the real estate market's reinforcement of spatial segregation is its direct support of racially motivated suburbanization. The low- and middle-income whites who lived in racially mixed neighborhoods were subsequently denied credit as well. After World War II, the home builders took advantage of the FHA subsidies, however, this was only allowed in white neighborhoods due to the appraisal requirement. Thus, the white residents of racially mixed neighborhoods left to ensure FHA subsidized housing in a secure white neighborhood. Moreover, these practices lead to neighborhood decline and disinvestment. This segregationist ideology was actually the real estate elite's deliberate attempt to exploit racial fears for their own financial gain. Demand for white families to migrate to a racially homogenous neighborhood inflated property values in White neighborhoods. Additionally, real estate agents were able to manipulate Black residents to make a profit (Gotham 2002; Massey 2008; Massey and Denton1993; Squires 1994).

This occurred through the 1960s unit the Federal Fair Housing Act of 1968, the Equal Credit Opportunity Act of 1974, the Home Mortgage Disclosure Act of 1975, and the Community Reinvestment Act of 1977, all of which shifted the policy of segregation to fair housing and mortgage lending (Squires 1994). Though, the policies were not always successful. The 1968 Act instituted Section 235 which relaxed lending standards to allow lending to the poor. However, this allowed real estate speculators to profit from property flipping with little improvements to the poor. It also perpetuated the "White Flight" ideology due to the stigmatism of Section 235 housing (Gotham 2000). The effect was deterioration in the black inner city neighborhoods. The real estate agents continued to assist in the dual housing market (Gotham 2000).

In much of the 20th century, there were many federally endorsed discriminatory practices such as restrictive covenants, redlining, and the institutionalized exclusion of minorities during the suburbanization boom all of which were marked by real estate elite profiteering. Now known as the "old inequality", these policies lead to severe racial segregation (Gotham 2000; Bond and Williams 2007; Williams, Nesiba and Mcconnell

2005). The changes in the 60s and 70s were insufficient and it was not until the 1990s that an increase of lending to low income and minority buyers occurred.

New Inequality

Many researchers have analyzed the consequences of these past institutionalized practices, however new methods were borne in the 1990s, which shaped the concept of the "new inequality". The shift came from economic restructuring resulting in the expansion of mortgage lending to high risk borrowers, often the poor and minority communities. This did not eliminate inequality in the housing market as one may expect, it simply took a new form. Instead of having trouble getting a loan, minorities are now subject to "less desirable loan terms, exposure to predatory practices and a lack of consumer protection,"(Williams, Nesiba and Mcconnell 2005). Though homeownership increased among the disadvantaged, the changes in the mortgage lending industry allowed for the influx of predatory practices by subprime lenders, such as reverse redlining (Williams, Nesiba and Mcconnell 2005).

The idea of laissez faire economics and neoclassical economics was expanded with the deregulation of the mortgage lending industry (Williams, Nesiba, Mcconnell, 2005). In effect, the elite private enterprises in the housing industry were able to secure private interests in the government which promote deregulation and not the public interest (Gotham, 1994). The transformation in the 1990s regarding deregulation in the market lead to major increases in homeownership, especially for low-income persons and minorities, (Williams, Nesiba, Mcconnell, 2005) through the means of subprime lending to borrowers with less than perfect credit, (Squires, Kubrin, 2006). This follows the neoclassical economic theory which highlights the positives of subprime lending, (Williams, Nesiba, Mcconnell, 2005). However, there are major pitfalls with subprime lending that can contribute to inequalities which is best represented by Tillman and Indergaard's (1999) application of sociological networks theory, (Williams, Nesiba, Mcconnell, 2005). Application of sociological networks theory on market restructuring indicates that opportunities for exploitation emerge.

This theory initiates the discussion of inequality in the housing sector through predatory lending. Subprime lending has resulted in a proliferation of loan defaults and common risky practices such as adjustable rate mortgages and also predatory lending practices such as steering of minorities towards the subprime market which have been in the forefront of today's research and policy initiatives (Carr and Kolluri Fannie Mae). These practices are purposefully committed against subprime borrowers for profit.

After decades of redlining and institutionalized segregation, the same people and areas affected by predatory and irresponsible subprime lending and continue to suffer from inequality. Thus, these predatory practices have been dubbed "reverse redlining." While redlining was a method of denying credit to minorities and low income individuals, predatory lending preys on these people by irresponsible lending. It simply perpetuates pre-existing inequality (Squires, Kubrin, 2006).

The New Inequality Extended

Clearly, restructuring of mortgage lending practices has greatly transformed the housing sector and the methods pertaining to uneven development. However, mortgage fraud, notably fraudulent property flipping, has not yet been directly associated with the new residential inequality theory. The effects are widespread in the areas inflicted with this fraud however a proper examination is needed in order to link flipping as a process of inequality.

Flipping can be considered another consequence resulting from the relaxed lending practices. Recently, there has been an extension of fraudulent activity detected which is not directly aimed at cheating the borrower. Due to its nature, the practice of illegal flipping can go virtually undetected for some time, but this is not a new phenomenon. However, it has emerged as the most common mortgage fraud practice (FBI.gov 2006) and with the state of the U.S. financial and housing markets it has become increasingly relevant. This fraud-for-profit scheme involves a wide range of illegal activities which intentionally allows the foreclosure of properties devastates neighborhoods and defrauds banking institutions. The neighborhood blight is severe and has negative consequences for residents such as and inability to sell their property, crime and effects from the housing bubble.

It may be difficult to see flipping as contributing to inequality because its intent is much different than the practices in the past, such as redlining. Whereas the old inequality intentionally segregated minorities away from the white and/or affluent community, flipping is an opportunistic practice of industry insiders to gain a profit. The segregative nature lies in the cost of their greed. The most direct effect is the cost to the banking institutions from which the perpetrators steal from; however, it is the secondary component that affect a neighborhood. The flippers inflict foreclosures on a neighborhood with little or no regard for the vicinity and its residents. Or, they may not understand the full effects that occur at this level. Nevertheless, the consequences are extensive. Also, if the scheme involves manipulating a buyer, rather than collusion, the buyer will most likely be left with an overvalued home in complete disrepair.

Thus, fraudulent flipping shares a number of similarities with predatory lending and the new inequality. First, both are schemes for profit. So the differentiation between intent of the old inequality and predatory flipping is compatible with the new inequality. An interesting facet of the old inequality is that an in depth analysis highlights similar profiteering, though not as blatant. However, the nature of the profiteering was racial segregation to manipulate demand rather than manipulation of increased supply of loans to low income people. In other words, the old inequality structured the dual housing market but the new inequality advanced and perpetuated the dual housing market. Second, even though it may seem on the surface that predatory lending and reverse redlining have a more direct effect on spatial inequality due to the disproportionate effects on minorities and low income populations, property flippers must target an area where they can buy homes for cheap. Thus, “there is growing evidence that property flipping has become epidemic in low-income urban housing markets,” (Focer, 2000). An examination by Ada Focer (2000) cites a Cleveland Plain-Dealer article that states “1000 flips, worth more than $31million, have occurred there since 1997, about 80 percent in the lowest income East Side neighborhoods,” (Focer, 2000). Thirdly, neither of these policies are institutionalized or condoned by the government. They are deemed fraudulent activities. Also, both practices are more centered on economic characteristics of lenders rather than racial characteristics like the old inequality. Finally, both predatory lending and fraudulent flipping have the same effects of foreclosure, neighborhood deterioration, and persistence of racial and economic segregation.

DATA AND METHODS

The case study of Slavic Village covers 1) the process and prevalence of flipping using comparative evidence nationally and in Slavic Village and; 2) a neighborhood analysis. The first portion includes documentary evidence on the situation in Slavic Village from a variety of sources including features from different media outlets, FBI data, and evidence collected from the Slavic Village Vacant and Abandoned Property Task Force. The second portion includes an observational survey of Slavic Village and incorporates census and property data.

Evidence of Flipping

I first developed a clear understanding of the flipping crisis in Slavic Village as in intern at the community development corporation, Slavic Village Development (SVD), in the summer of 2007, where I attended a few task force meetings. The identification of predatory flipping came from Councilman Anthony Brancatelli, former SVD director and current city councilman for the area. He began to notice property inflations on decrepit properties in Slavic Village as early as 1999 (New York Times 2009). Around 2005 he noticed a great deal of real estate transfer listings in the Cleveland Plain Dealer with the same issue. Further delving into the property sales illuminated patterns of similar buyers and sellers, mortgage lenders and evidence of property flipping. He soon shared this information with his ties at SVD and the task force (The Plain Dealer 2008).

I also contributed slightly to The Slavic Village Vacant and Abandoned Property Task Force report entitled Subprime Lending, Real Estate Flipping, and the Foreclosure

Crisis in Slavic Village 2003-2008. My tasks included checking MLS listings from the Slavic Village area for possible illegal flipping red flags on the Cuyahoga County Auditor's website, and the Cuyahoga Clerk of Courts website in order to add to the flipping database. Red flags indicated on the property's history on the websites include; a short turn-over period, large discrepancy between buying and selling price, inflated selling price compared to County assessed market value, foreclosure before and after flipper transaction, and common flipping cohorts. Most importantly, the brief time I spent at Slavic Village Development allowed me to gain knowledge of the process and become familiarized with crisis as a whole.

I relied extensively on the final version of the Task Force Report, which includes a table identifying Selected Flipper Transactions in SVD Service Area 2003-2006. These transactions were chosen based on the severity of the flip, such as a significant discrepancy between the flipper's sales price and county assessed value. The report highlights the high frequency of fraudulent speculator activities in Slavic Village. There were 126 selected transactions. According to the Cuyahoga County Prosecutor, 78 of these properties were perpetrated by the same mortgage broker, Mark Kellogg, and his flipping ring (Cuyahoga County Prosecutor)

Recently the FBI has compiled as much data as possible on mortgage fraud and fraudulent property flipping and is committed to combating mortgage fraud (FBI.gov Mortgage Fraud Overview). The FBI mortgage fraud reports rely heavily on the Financial Crimes Enforcement network and Suspicious Activity Reports for estimates on the prevalence of fraud. There are many types of mortgage fraud which are reported by the Financial Crimes Enforcement Network (FinCen) Regulatory Policy and Programs

Division. Though, there is not a mandatory system of fraud reporting for all of the financial institutions, the FinCen reports are based on Suspicious Activity Report (SARs) Analysis. The SARs are in a database filed from a portion of financial institutions. The November 2006 report contains data from April 1, 1996 through March 31, 2006 and a second report reviews data from April 2006 through March 2007. These reports show the increasing prevalence and trends of mortgage fraud activities. The two main suspicious activities looked at in this paper are illegal property flipping and appraisal fraud. However, there are other schemes that are also associated with flipping such as material misrepresentation/false statements and straw buyers.

I continued to research newspaper articles and other documentary evidence of Slavic Village including its problems with predatory and irresponsible lending, foreclosures, and fraudulent flipping in order to investigate the effects of flipping, to understand the conditions that allowed the opportunity to commit fraud, and assess the national implications on the current financial state. The national media has focused on Slavic Village as the epicenter for foreclosures and fraudulent flipping. Newsweek published the article, "How Questionable Loans Created a Cleveland Slum" in 2008 which explains the process of flipping based on the workings of mortgage broker Mark Kellogg's flipping ring, responsible for 71 flips at the time of the article (currently being prosecuted for 78 properties). CNN Money published a series of articles under the category Cleveland: Foreclosure's Perfect Storm which dealt with the Slavic Village crisis in particular (CNNMoney.com). The New York Times Magazine also published a thorough article entitled "All Boarded Up – Slavic Village and the Foreclosure Crisis." The Washington Post and NPR also published articles of similar importance. In addition to the national media recognition, various Congressional Hearings also document the troubles in Slavic Village.

Neighborhood Observation

A significant portion of my research is derived from a survey of Slavic Village and an analysis on property condition and sales prices. In a series of 7 trips from January to April 2009, I drove around and surveyed the condition of the properties in several census tracts and noted the overall state of the neighborhood. The fraudulently flipped properties were highlighted red on the map of Slavic Village. Census Tracts with many flips were distinguished from tracts with few flips. Census tract 1149 was chosen to be the representative sample of a Slavic Village tract with many flips. There were 23 flips in this area. The neighborhood was surveyed marking and color coding properties as 1) flipped in red, 2) vacant in magenta, 3) boarded in purple, 4) substandard condition in green, and 5) average or good condition in yellow. This determination is based on several factors such as; broken windows, roof condition, siding condition (including if it has been stripped for aluminum), and condition of the yard. A property determined as substandard usually will have multiple substandard criteria. The categorization of the properties is subjective. The properties are compared to each other and the condition must be determined in the overall context of a low income neighborhood. For example, a property considered average in this neighborhood may be considered poor condition in a more affluent neighborhood. The methodology I incorporated into the study of surveying Slavic Village is taken from the methodology of Robert Sampson and Stephen Raudenbush in their article "Ecometrics: Toward a Science of Assessing Ecological Settings, with Application to the Systematic

Social Observation of Neighborhoods" in which they cite the observation and surveying of a neighborhood as an important statistical tool in assessing a neighborhood condition (Raudenbush and Sampson 1999).

The homes that were evaluated were single- and multi- family residential homes excluding apartment buildings. Land Bank vacant areas and homes with a rental disclosure owned by Cleveland Housing Network were not accounted for due to the skewed data for the purpose of market value and sales prices. This includes many of the new subdivisions built by non profit groups. 917 properties in tract 1149 were accounted for and analyzed in this study.

The properties and their condition are plugged into a spreadsheet along with market values and sale prices. Market value assessments are determined by the county with an update every three years. The years documented in this study are 1997, 2000, 2003, and 2006. The data from 2009 has not yet been published. The sales data is compiled from 1997 to 2008. The data on the sales is intended to determine the impact of fraudulent flips on neighborhood sales and tax values. The color coding of the properties is also used to compare condition to value. The median values have been calculated and graphed.

RESULTS

The Process and Prevalence of Flipping in Slavic Village

FBI defines mortgage fraud as a scheme involving a mortgage with "material misstatement, misrepresentation, or omission…" (FBI.gov). It is categorized as fraud for profit and 80% of fraudulent schemes are committed by industry insiders. Slavic Village has been hit hard with fraudulent flipping and appraisal fraud which is usually perpetrated by the same cast of characters from 2000-2007.

Illegal property flipping involves a process of obtaining false documents in order to sell a cheap, dilapidated property most likely in a low income neighborhood for an inflated profit. The flipper purchases this home for a low price and obtains fraudulent appraisals to value the property for more than it is actually worth. A buyer, usually involved in the scheme, takes out a hefty loan for purchasing the property. Many times, straw buyers do not qualify for a loan; however the "flipper" employs crooked mortgage brokers who falsify documents to make sure they qualify. This process is facilitated by the relaxed lending standards of subprime lending and the securitization of the market which decreases the lender's risk of loaning to unqualified buyers. No-document loans do not require income and important financial indicators to be reported. However, sometimes an inexperienced straw buyer is solicited for a fee and duped as they are left responsible for the property, destroying their credit. Finally, the title company and mortgage broker can be involved, committing indiscretions of falsifying documents and lying to the lending institution. The loaned money is taken as a profit and then split with the flipper's conspirators including the buyer, the appraiser, mortgage broker, and title companies. Eventually, the borrower will not make payments resulting in foreclosure of the home.

There has been an incredible increase of mortgage fraud reporting overall. Between 1997 and 2005 SARs categorized as mortgage loan fraud increased by 1,411% and continues to increase in 2006. There are many structural factors that have contributed to this increase. The 2006 report attributes the "increased awareness of the potential for fraud in a dynamic real estate market," (4) as one explanation. In other words, the perpetrators have capitalized on the rapidly increasing property value growth during this time period (2006 FinCen; FBI Financial Crimes Report). Nationally, the average annual growth rate in property values was 6% between 1975 and 2005. However, in the first quarter of 2005 the national growth rate was 12.5% (2006 FinCen). Moreover, industry insiders, involved in 80% of reported fraud losses, have incorporated an "educated criminal element that is using identity theft, straw borrowers, shell companies, along with industry insiders, to conceal their methods and override lender controls" (FBI Financial Crimes Report). The relaxed lending policies, including little or no-document loans has facilitated fraudulent activity (2006 FinCen).

The 2007 FBI Financial Crimes Report to the Public advises not to compare predatory lending practices with mortgage fraud because predatory lending affects borrowers whereas mortgage fraud affects lending institutions. While this fact is true and there are ways in which they differ, both practices yield similar results of foreclosure, blight, and neighborhood deterioration, which in itself translate into inequality. Property flipping flourishes due to increasing property values, but eventual foreclosure will ultimately lead to severe decline in property values for the flipped property and neighboring properties, perpetuating inequality. Both practices disproportionately and negatively affect, subprime, low income people.

The dynamics of the lending market caused a significant concentration of deterioration and foreclosure in Slavic Village. Investigations identified an additional factor, fraudulent property flipping, which was contributing to the foreclosure crisis. Flipping both benefited from and contributed to the severe foreclosure crisis. Subprime and irresponsible, often predatory, lending, which basically obliterated Slavic Village, has paved the way for mortgage fraud in the form of fraudulent appraisal and property flipping to occur. The predatory flippers were able to take advantage of the situation in Slavic Village. This irresponsible lending has created an unequal footing for the people living in the neighborhood, for both subprime borrowers and their unsuspecting neighbors. The Vacant and Abandoned Property Task Force in Slavic Village indicates that this area has been overwhelmed with high-cost or subprime loans. They have documented that 68% of loans originated in the area were defined as high-cost between 2005 and 2006. This is substantially higher than the national average which was between 26% and 28% during the same period. Moreover, research shows that the "Strongest predictor of a loan foreclosing is its status as subprime," (Coulton et al. 2008). While subprime loans have allowed for an increase in home ownership based on racial and economic characteristics, there are indications that subprime loans are segregated by income and race just as the housing market has historically been (Coulton et. al. 2008).

Slavic Village shows characteristics of a low income neighborhood. In Slavic Village, the 1999 poverty rate was approximately 27% and the median household income was approximately $24,500 according to the 2000 census (NEO CANDO). It is also one of 6 neighborhoods in Cleveland included in the Neighborhood Progress Inc. Strategic Investment Initiative. This program intends to restore neighborhoods and initiate "market recovery" (neighborhoodprogress.org). This distinction is due in large part to the neighborhood vacancy and foreclosures resulting from the subprime lending and inexperienced homebuyers.

Mortgage fraud results in significant costs both to the banks and to the cities. Mark Kellogg who is responsible for 78 flips in Slavic Village accounts for the loss of $5.8

million in loans defrauded and stolen from various banking institutions (Cuyahoga county prosecutor). The FBI cites a $1 billion dollar loss in loans in 2005 from various mortgage fraud schemes. However, it is difficult to record the exact amount of SAR activity so the cost is projected to be higher (SAR). The cost to the city and taxpayers is also grave. One of the most significant outcomes from foreclosed and abandoned homes is the increase in unkempt properties. They are both an eyesore and a costly nuisance. CNN reports the fees to the city are lawn upkeep and board up liens. The average cost to cut grass for one lot in Slavic Village is $300. Cleaning trash from a yard can cost $1,000 and board up fees can cost around $500. The Cuyahoga auditor also shows charges for sewers and demolition fees. There are also numerous homes in Slavic Village that are unoccupied or boarded so the cost skyrockets. In 2007, Jim Rokakis, Cuyahoga County Treasurer, reports to CNN that more than 800 homes are vacant in the area.

Fraudulent flipping has had similar consequences as reverse redlining and other forms of inequality resulting from abandoned homes. In 2007 Cleveland had four of the top 21 ZIP codes for foreclosure filings in the United States. The Slavic Village area zip code, 44105, tops the June 2007 list in the entire U.S. with 783 foreclosure filings (CNN). CNN reports a high incidence of crime in Slavic Village resulting from vacant homes. Rokakis explains the first result of foreclosure is the emergence of squatters and looters into the abandoned homes. The average time for a newly vacated home to be looted is 72 hours. Gutters are removed and properties are littered with trash. One of the most apparent crimes is the stripping of aluminum siding and piping, including copper, wiring, and PVC. The purpose is to sell the commodities on the black market. The homes are left worthless and in need of costly restoration. The article reports the need of $100 million for repairs.

Due to this cost, it is often more appropriate to simply demolish the house, another devastating blow to the community. Stacy Pugh, housing director at SVD also cites arson as another crime resulting in deterioration of the neighborhood. The value of their neighboring homes has deteriorated greatly. Mike Graham, Cleveland representative for a national appraisal company Zaio Corporation, reports to CNN that the 25-40% home devaluations in Slavic Village compared to the 4.2% for all of Cleveland. This results in the inability for neighbors to sell their homes. They are stuck and surrounded by blight and crime. The purposeful foreclosing of illegally flipped homes exacerbates the situation.

Mortgage fraud, including property flipping and appraisal fraud, have serious implications on the national financial market. In an April 1, 2009 statement before the House Committee on the Judiciary John S. Pistole, Deputy Director of the FBI recently referred to the importance of mortgage fraud on the U.S. economy. In the current financial crisis, "financial institutions have reduced their assets by more than $1.2 trillion." Pistole continues to explain that while mortgage fraud is not the "sole source, of the current financial crisis; however, it would be irresponsible to neglect mortgage fraud's impact on the U.S. housing and financial market."

Flipping and Neighborhood Decline

The survey taken of Slavic Village recorded the intense blight seen in the tract accounting for 917 residential properties excluding land bank. Substandard homes accounted for 13% of the tract, boarded homes for 11% and demolished for 10%. Together the blight accounts for 34% of the neighborhood. 23 properties were fraudulently flipped which accounted for 3% of the tract. The majority of the homes (63%) were in standard condition for the neighborhood tract. This demonstrates the polarization of the housing market in Slavic Village. While some homes are severely deteriorated, others are relatively nice working class homes. The standard condition category contains a variation of homes considered standard condition including those that are new construction and those that are well kept, older homes. One shortcoming of this study is the failure to represent the full effect of abandoned homes because many of the standard homes may be in some stage of the foreclosure process. Figure 1 shows the results of the survey in tract 1149.

The data on the condition of the properties including vacancy and foreclosure highlights the concentrated poverty and blight in the area. The appearance of blight is obvious simply by driving around and observing the differences among streets. Some streets have been hit harder than others, as the fraudulent and/or flipping properties tend to be concentrated together. Moreover, some census tracts have been hit harder than others. These areas that are targeted by the flippers are usually areas that have already been devastated by foreclosure due to the subprime lending problem in the area. The subprime lending problem resulting in foreclosures has lead to the opportunity for fraudulent flippers to buy properties for a cheap price. The perpetrator can use the more expensive rehabbed properties in the area to account for the high value of the fake appraisal. Once a property has been flipped, the neighboring properties are favorable areas to continue to process all over again because they can now use the fraudulent appraisals and sales prices as comparable data. Therefore, entire streets are often plagued by severe deterioration. The blight a street has incurred from inexperienced homebuyers being foreclosed on is worsened by the flipped properties that populate the area. For example East 65th St. in tract 1149 contains 3 fraudulently flipped properties. The street is divided in half by average condition and deteriorated condition. East 70th in tract 1149 contains 2 flipped properties and 60% of properties are deteriorated.

According to HUD user the estimated foreclosure rate in tract 1149 was 16.7% between January 2007 and June 2008. The estimated amount of foreclosures was 51. In all of Slavic Village the estimated rate was 15.8% and the amount of estimated foreclosures was 537. This means that the selected tract 1149 accounted for 10.5% of the estimated foreclosures in Slavic Village during this time period. HUD user also documented data from the United States Postal Service on 90 Day Vacant Residential Addresses as of June 2008. Tract 1149 had 327 vacant addresses. This accounts for 27.2% of the 1,200 address tract. The average vacancy rate for Slavic Village was 15.95%. Figures 3 and 4 depict the available data from Cleveland and Northeast Ohio Indicator Data (NEO CANDO) at Case Western Reserve of residential foreclosure filings and residential vacant addresses in Slavic Village and tract 1149 over the height of the crisis from 2006-2009. These figures represent the high foreclosure and vacancy rate which has resulted from the subprime mortgage crisis in Slavic Village. While this crisis has caused severe blight, the data of this study shows that the flipped properties have benefited from the crisis and further perpetuated the deterioration. The flipped properties are most likely to be properties that were previously foreclosed and forced back into foreclosure contributing to the deterioration from the foreclosure crisis.

The sales and market value assessments are telling of the problem of over inflated values in Slavic Village especially when compared to the condition of the properties. The property sales are highly polarized. Also, there was a great deal of evidence which showed characteristics of flipped properties other than those identified in the selected transactions

Table in the task force report. The properties not found in the task force report are either legitimate property flips or additional fraudulent flips. Additional analysis will be needed in the future to make the differentiation. Regardless, each of the property flips (both legal and illegal) have contributed to the increase in median sales values for the entire tract. Consequently, this will effectively increase the median county assessed market value for the tract. Understanding the county appraisal process is essential to this study and appreciating the problem of overvaluation and the makings of a housing bubble. The value of a property is determined in a large part to comparable neighboring sales. This means that if a property sells, even fraudulently, for $80,000 it will increase the appraisals of the neighboring properties. The result is a slew of overly inflated property values and the creation of a housing bubble. Figure 4 shows the appearance of a property bubble in tract 1149 of Slavic Village. The percent appreciation from the previous year for sales and market value are high. Of course in the period after 2006 the sales values have seriously plummeted. The median sales percent change is shown in Figure 5. The median sales percent change shows volatile changes in the median sales in tract 1149 but illuminates the overall trend of a housing bubble with overall increase until 2005 and the subsequent crash. The market value shows a relatively stable increasing trend even with the volatile changes among different years. The appreciating sales values overall before the 2006 crash and stable market value trend, which depict the beginnings of a housing bubble, are suspect when compared to the nearly 40% blight in the area.

The condition of the properties in the area represents the concentrated blight. While it can most likely be assumed that other factors, such as predatory and subprime lending, have resulted in the deterioration of the neighborhood, it is important to assess the contribution of the flipped properties and resulting foreclosure. The median home sales values of tract 1149 and flips in 1149 are documented in Figure 6 along with the average market value in the tract showing the discrepancy among flipped homes (both legally and illegally) and the average sales prices in tract 1149. The large sales amounts are used to assess the market value of all the properties which will most certainly over inflate the values of deteriorated homes. The high sales prices of flipped properties are essentially able to sustain the increase in the market value even when total median sales prices for non-flipped properties are low such as during the 2001 and 2003.

While the true number of fraudulently flipped properties in the tract is unknown, they account for at least 3% of the properties in the tract and most likely more. These are properties that have usually been previously foreclosed properties that are purposefully forced back into the foreclosure cycle. The flippers have taken advantage of the severe polarization and overvaluation of properties in the area. They are able to buy a property at a low price and pass it off as a high valued property.

CONCLUSION

The data leads me to the conclusion that illegal property flipping can reasonably be associated with inequality, or rather an extension of the new inequality. This determination is based on its similarities to other forms of inequality; specifically: the impact on neighborhood blight and foreclosures, increasing prevalence and media attention, and its impact on the U.S. financial crisis. As a result, appraisal fraud and illegal property flipping have debilitated low-income neighborhoods, capitalizing on their existing issues of inequality ultimately perpetuating and worsening them.

The distinction of illegal property flipping as a mechanism of inequality is supported by the similarities it has with predatory lending. Though lending institutions are the direct and apparent loser in a flipping scheme, the effects on the neighborhood and its residents is pervasive and widespread. In both schemes, all the residents can be affected due to the consequence of foreclosures. Also, both have capitalized on cracks in the mortgage lending system due to the availability of subprime loans and relaxed lending standards. Banks have contributed by their lack of oversight due to their decreased risk with mortgage backed securities and the perpetrators are able to get away with fraud. Both lending schemes are opportunistic in nature. They are for profit schemes and have little or no regard for the consequences on others, most notably low-income people and neighborhoods. The result is a neighborhood devastated by foreclosure, vacant properties, and unaffordable homeownership.

Appraisal fraud and property flipping have two additional consequences leading to inequality which contribute to the current U.S. financial crisis and the impact on the housing bubble. Banks have been purposefully defrauded out of unaccountable amounts of money which has in part lead to their demise. The flippers also capitalized on the housing bubble in the U.S. and perhaps sustained and added to it. This aspect is highlighted, among other things, in the case study of Slavic Village.

In Slavic Village the appreciation in prices has allowed for this form of fraud and has in turn contributed to the appreciation of the housing market. In the end, it has become unaffordable and has lead to a severe decline in the market. Moreover, due to the overvaluation of property, the values do not reflect the condition of the homes. This is damaging to homeowners because it affects their ability to sell the home, perhaps because their mortgage is too high. They will lose this money. Also, if the house goes into foreclosure and the bank acquires the property, they have also lost money. The foreclosures also have deteriorating affects on the neighborhood including the impact of the broken glass theory, abandoned unkempt properties, and opportunities for crime. Deterioration and blight ultimately results in unequal opportunities for residents.

This opportunity to commit fraud resulting in the perpetuate inequality of low-income neighborhoods illuminates failures in the system that need to be corrected. The first failure is the nature of subprime lending. Higher standards need to be instituted to properly ensure that people can afford the loan they take out by eliminating no-document loans. This will also eliminate an opening for fraud in the system. Banks are not blameless. In order to guarantee a more sound system for banks, borrowers, and neighborhood residents, the banks need to take a more proactive stance in overseeing their lending habits to make sure the home actually is as it appears on paper. Mortgage brokers need to be regulated. There are currently very few restrictions on becoming a broker which has opened the profession to fraud and deception. The property bubble has illuminated the unsustainable nature of overvaluation and rapidly appreciating properties. Even with legal flipping it is necessary to take precaution in revitalizing a neighborhood. Slavic Village is an example of a neighborhood with polarized housing values. If only some of the properties are rehabbed, this actually leads to the opportunity for lower valued homes to suffer through overvaluation, especially based on a deteriorated condition. I propose that a new method of county appraisals may be needed to ensure a dual housing market does not suffer. Throughout the history of housing inequality, appraisals have been an integral part in allowing inequality to prosper. Policymakers should keep this aspect of property values in mind and need to reform the system.

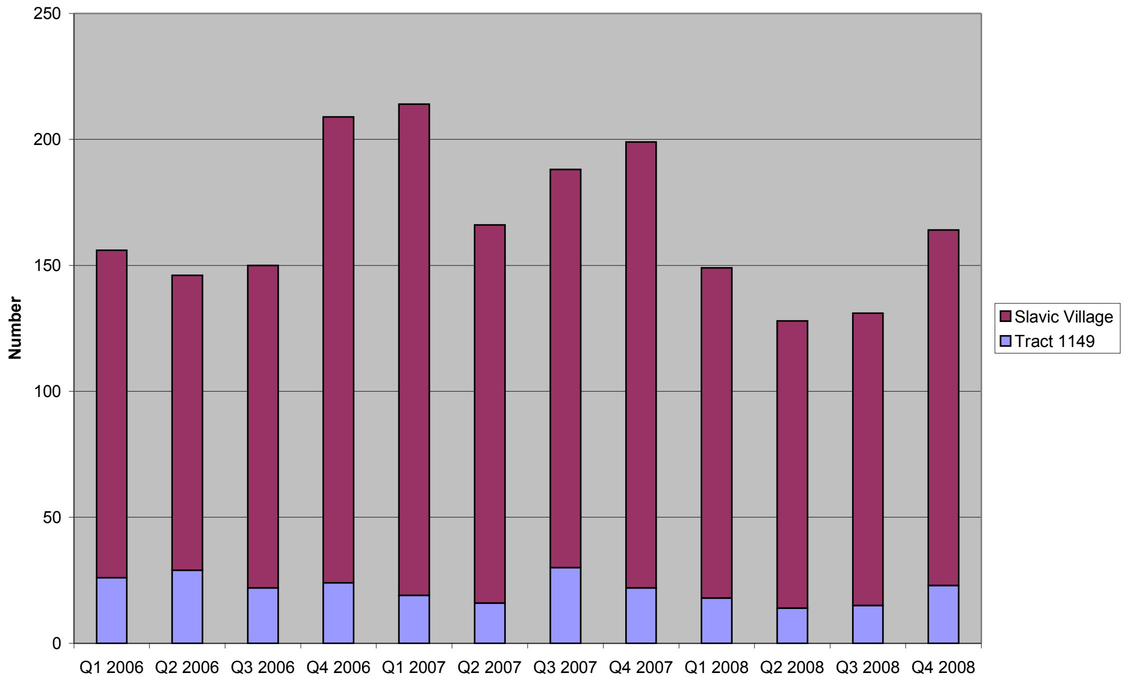
Inequality in housing no longer needs to be a form of intentional segregation. The long standing racial and economic segregation and inequality already in place has become an opportunistic method for people to make a profit at the expense of the underprivileged; and the result is a cycle of inequality with no end in sight.

Figure 1


BATES AVE
BURR AVE
E 79TH ST
E 78TH ST
E 77TH PL
E 76TH ST
E 73RD ST
E 72ND ST
E 71ST ST
E 70TH ST
E 69TH ST
HAND AVE
IVY AVE
MORGAN AVE
TEMPLE AVE
REGENT RD
BOSTON AVE
OVINGTON AVE
CHARTER AVE
CONSUL AVE
HINDE CT
ADOLPHA AVE
PORTAGE AVE
CABLE AVE
ENGEL AVE
HILLMAN AVE
MORTON AVE
HAMLET AVE
DRAKE AVE
LUFKIN AVE
E 57TH ST
E 56TH PL

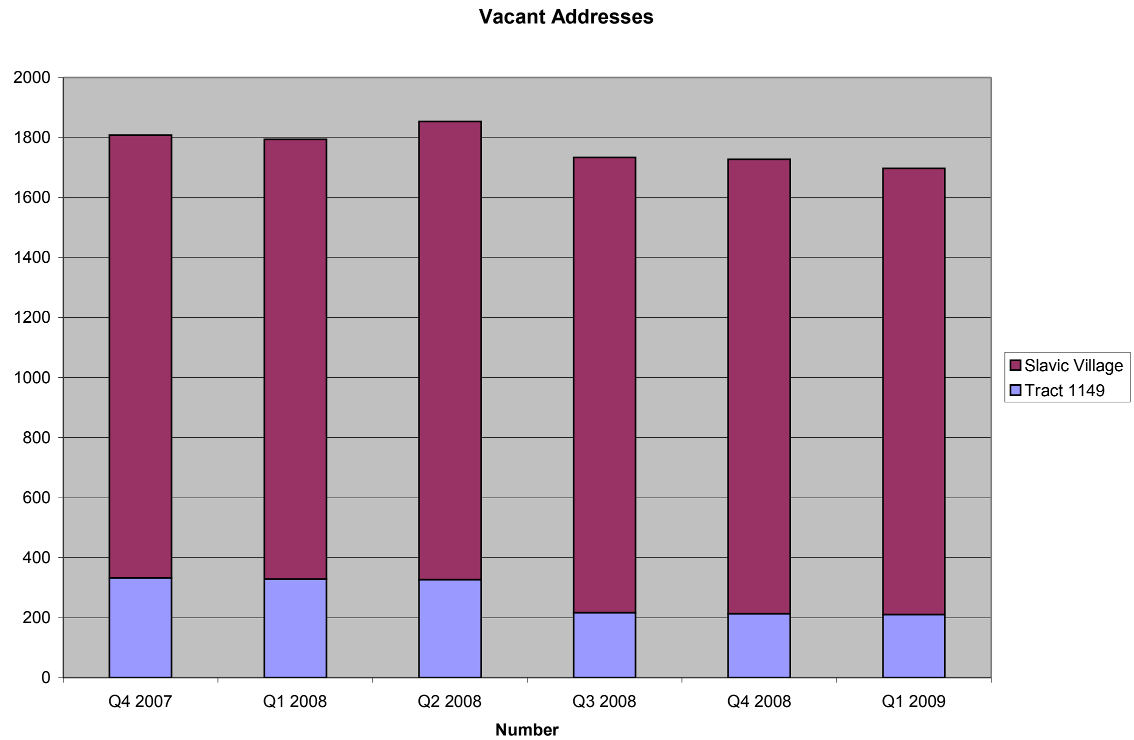
Figure 2

Foreclosure Filings in Slavic Village



Tract	26	29	22	24	19	16	30	22	18	14	15	23
SV Total	156	146	150	209	214	166	188	199	149	128	131	164

Figure 3



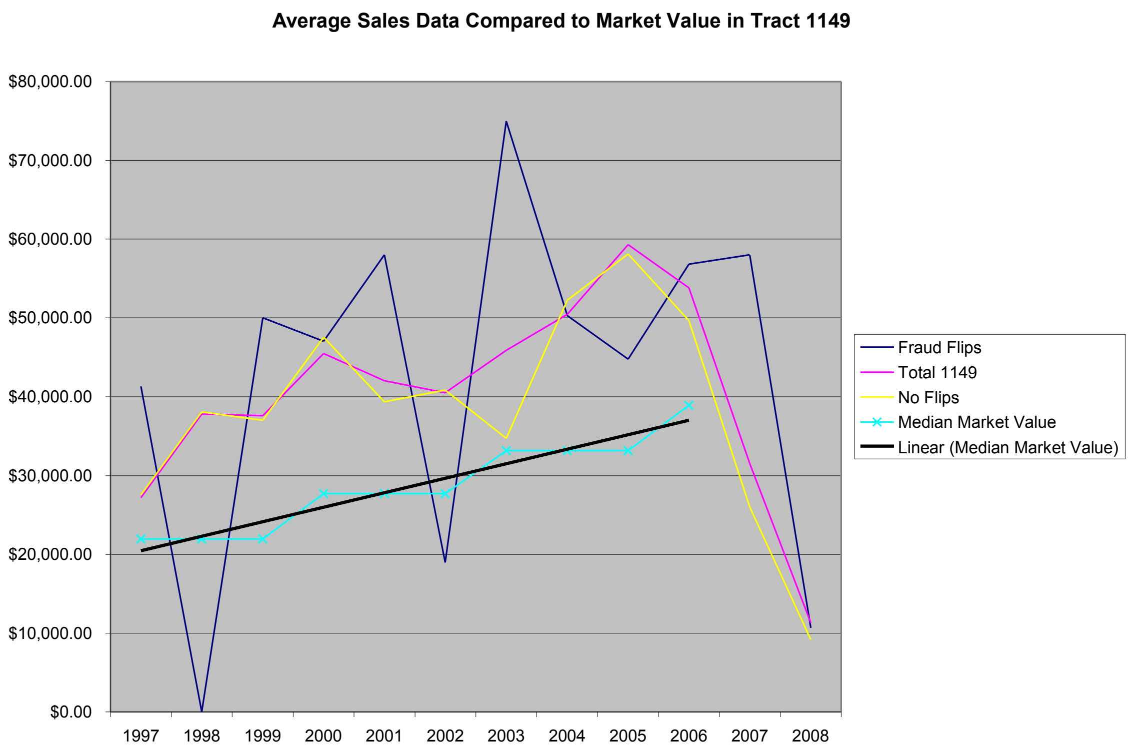
Tract	323	329	327	217	213	211
SV Total	1,808	1,794	1,863	1,733	1,727	1,697

Figure 4

Figure 5

Sales Year	‘98	‘99	‘00	‘01	‘02	‘03	‘04	‘05	‘06	‘07	‘08
Appreciation From Previous Year	39%	-1%	21%	-8%	-4%	13%	10%	16%	-8%	-42%	-64%

Figure 6


Average Sales Data Compared to Market Value in Tract 1149
$80,000.00
$70,000.00
$60,000.00
$50,000.00
$40,000.00
$30,000.00
$20,000.00
$10,000.00
$0.00
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
Fraud Flips
Total 1149
No Flips
Median Market Value
Linear (Median Market Value)

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